In addition to allowing the use of economic lives on a going-forward basis, access reform must also address the issue of the reserve deficiency associated with today's embedded investment. This issue is discussed below.

6. All Interrelated Dockets Must Recognize Their Interdependence

The Notice recognizes that access charge reform, interconnection and universal service all present related issues which must be addressed in a holistic manner.[21] The Notice also notes that separations reform is critical to any access regime which recognizes economic costing principles.[22] U S WEST wholeheartedly concurs in these observations. However, we are concerned that the Commission not use a series of dockets to avoid addressing the big issues in any particular docket by repeatedly putting key issues off until the next docket. It is very disconcerting, for example, to see representations to the effect that the universal service proceeding will deal with existing implicit subsidies in the interstate access charge regime,[23] while at the same time seeing nothing in the Universal Service Notice of Proposed Rulemaking which would indeed deal with the existing interstate subsidies. Equally troubling, the Notice itself speaks of transitioning access to economic cost levels while again shunting the issue of recovery of the very real costs of LECs which do not match up to economic costs to unspecified other proceedings, now

[21] Notice ¶ 5.

[22] Id.

[23] Such a representation was made, for example, by Commission counsel at the oral argument on January 17, 1997 in Iowa Utilities Board v. FCC, Nos. 96-3321, et al. (8th Circuit). See also Remarks of Reed Hundt before The Competition Policy Institute, Jan. 14, 1997 at 2.

primarily separations reform and rebalancing interstate rates to assign costs to cost causer (e.g., the SLC).[24] We cannot emphasize too strongly that access charge reform cannot take place in a vacuum, and that the clearly necessary movement of access charge prices to levels intended to create proper economic signals must occur in tandem with separations reform, universal service implementation and proper overall rate rebalancing. To the extent that access charge reform precedes any of these other related reforms, a transitional mechanism to recover the elements of access charges which reflect implicit subsidies inherent in the current system will be necessary. Rebalancing interstate rates based on assigned costs is, of course, within the Commission's power.

B. The Scope Of The Notice Is Overly Regulatory (¶¶41-49, 149-155)

The Notice recognizes the vital symmetry between the Commission's interconnection rules, but does not completely trust the economic consequences. It is well recognized that interstate access and interconnection, while not exactly the same, are logical substitutes for each other. Several key rulings have been made by the Commission to avoid the consequences of permitting complete substitutability before other crucial regulatory reforms have been completed -- the most significant of which is the decision that a carrier cannot purchase local switching as a network element substitute for interstate switched access unless the carrier serves the end-user customer as a LEC.[25] But regulations cannot in the long run thwart market

[24] Notice ¶ 14.

[25] See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers

forces (although, to be sure, regulations can seriously distort market forces). The fact that interconnection is a technological substitute for switched access cannot be ignored -- or, in the long run, prohibited.

The Notice pays too little attention to this essential fact. Rather than trust the economics of interconnection, the Notice speculates about possible contingencies which have little bearing in fact or experience. The reliance on speculation is most obvious in the following brief passage from the Notice:

> At Phase 2, if an incumbent LEC attempted to establish an inefficient rate structure, an IXC would be able to avoid paying above-cost rates by using cost-based unbundled network elements to originate and terminate toll traffic, or by acquiring access from a competitive provider. We will be able to rely on the presence of competitors to oblige the incumbent LECs to establish rate structures that reflect the manner in which costs are incurred. We do not propose to introduce this reform at Phase 1, even though unbundled network elements can act as an effective substitute for switched access at that point. We tentatively conclude that we should allow the Phase 1 reforms to take their effect prior to eliminating our mandatory rate structure rules, because it is not clear that the mere existence of efficient rate structure rules for unbundled network elements will cause incumbent LECs to adopt efficient access rate structures.[26]

In other words, the Notice does not trust the logical implications of the adoption of interconnection pricing based on economic cost because other potential outcomes are possible. We submit that the Commission should reverse this presumption. Rather than assuming, as the Notice does, that the market should not be trusted because it does not take care of every contingency in advance, the Commission should assume

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and Commercial Mobile Radio Service Providers, Order on Reconsideration, 11 FCC Rcd. 13,042, 13047-49 ¶¶ 10-13 (1996)

[26] Notice ¶ 214.

instead that basic market and economic forces will work unless demonstrated to the contrary.

This is particularly the case with regard to the interchangeability between access and interconnection. No matter what the Commission's general concerns about the economics of access may be in a vacuum, the fact is that uneconomic access rates or rate structures cannot long stand in the face of interconnection. Somehow carriers will find a way around access rules which attempt to prevent uneconomic substitution of interconnection for access. Often these circumventions will themselves be based on uneconomic market signals. The Commission should set as a primary goal the ability of LECs to harmonize access and interconnection as quickly as possible. In order to accomplish this result, two essential decisions must be made: 1) The presumption that regulations should be considered until all possible future contingencies of the marketplace have been dealt with should be abandoned. Instead, regulations should be presumed to be unnecessary unless demonstrated otherwise. 2) The essential harmonization between access and interconnection cannot take place in a timely manner through pricing or rate structure rules. The Commission should permit carriers the greatest possible flexibility to devise their own rate structures and prices for access -- immediately.

Several key decisions can be made quickly in this context.

- The local switching and local transport elements of switched access should be significantly deregulated quickly, at least as to structure. While the Notice is correct that much of the structure of these elements is uneconomically devised, there is no reason to rely on regulatory fiat to fix this problem. Carriers should be permitted to utilize whatever structures for local transport and local switching

which are reasonable and meet their own needs and the needs of their customers.

- The introduction of new services should be even further simplified. The Report and Order part of the Notice modifies the new services introduction rules to permit introduction of new services based on a public interest standard. (¶¶ 309-310) This action is beneficial -- prior rules which made it more difficult for LECs to introduce new services and new technology obviously have no place in the new statutory scheme under the 1996 Act. However, this action does not go far enough. While the public interest test is certainly far superior to the earlier approach to new services, there does not seem to be any good reason why new services could not be introduced based simply on a tariff filing which is presumed to be reasonable unless demonstrated otherwise. In addition, there is still no time limit for Commission action on a totally new service or rate element. Of significantly greater importance, the Commission's current interconnection rules create significant disincentives against LEC introduction of new services. Under the existing interconnection rules, it would appear that new services and new investment would need to be unbundled and offered to competitors at TELRIC prices based simply on a showing of "administrative convenience." If such is the rule, this would mean that a LEC which made an investment in new technology (which by definition cannot be part of the LEC's "bottleneck" because it has not been installed) would need to immediately share all competitive advantage which the investment gave the LEC with all of the LEC's competitors. Under such circumstances, as the LEC would simply be investing to aid its competitors, not itself, the investment would generally not be made. The Commission should clarify, in this or another appropriate proceeding, that its rules regarding new services are meant to encourage, not discourage, new services and investment by both ILECs and competitive local exchange carriers ("CLEC"). It's rules should encourage facilities based competitors rather than resellers.

- The Commission should immediately permit all LECs to offer contract tariffs in the same manner which AT&T was permitted to offer contract tariffs pursuant to the Tariff 12 orders.[27] Such

[27] See In the Matter of AT&T Communications Revisions to Tariff F.C.C. No. 12, Memorandum Opinion and Order, 4 FCC Rcd. 4932 (189), rev'd and remanded sub nom. MCI Telecommunications Corp. v. FCC, 917 F.2d 30 (D.C. Cir. 1990), Memorandum Opinion and Order on Remand, 6 FCC Rcd. 7039 (1991).

contract tariffs would need to be available for resale in the same manner as AT&T's contract tariffs were subject to resale requirements,[28] but a "discount" below the price offered by the contract would not be appropriate.

These several deregulatory steps can be undertaken fairly quickly. The Commission, in this docket, must continue to search for means of replacing regulation with market forces. The complex structure rules suggested in the Notice do not generally move in the correct direction in the area of deregulation.

II. EXCHANGE ACCESS SERVICES SHOULD BE DEREGULATED AS THE LOCAL MARKET OPENS TO COMPETITION

A. Deregulation Must Be The Ultimate Goal Of Any Access Charge Reform Plan (¶¶140-60)

The Commission should adopt an access reform plan to move the industry to competition and full deregulation. Though reaching that goal will require an incremental approach, the steps along the way must be swift and certain. That is, each step must be triggered by a specific, objective, easily-determinable standard related to the implementation of conditions necessary to meaningful competition. "Meaningful competition," in this context, is competition sufficient to constrain the practices of the ILECs so that consumers have available to them "rapid, efficient . . . communication service with adequate facilities at reasonable charges,"[29] regardless of any action the ILEC might undertake in its retail markets.

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[28] See In the Matter of AT&T Communications Tariff F.C.C. No. 12, Petitions for Reconsideration, Memorandum Opinion and Order on Reconsideration, 4 FCC Rcd. 7928, 7930 ¶ 17 (1989).

[29] 47 USC § 151.

The 1996 Act expresses a clear preference for competition in telecommunications markets. It requires the telecommunications industry to undertake a series of steps designed to bring competition to all segments of the industry, including the local exchange. As competition emerges in local telecommunications markets, the 1996 Act obliges the Commission to deregulate the services under its jurisdiction. New Section 10 requires the Commission to forbear application of "any regulation or any provision" of the Communications Act once the Commission determines that certain conditions have been met.[30]

With this provision, Congress has plainly directed the Commission to deregulate telecommunications markets as they become competitive. The 1996 Act has thus enacted into law the judgment that regulation is justified only when competition is not available to "regulate" a market. And when competition emerges -- when it governs the provision of services to a market -- regulation must give way.

No one would argue with this principle. The disagreement comes over the implementation: what are the relevant criteria, and how much deregulation should accompany each milestone. The Notice proposes what can only be described as a cautious approach -- overly cautious, in our view -- to deregulating access services. It would allow the ILECs some regulatory flexibility in phases when competitors have successfully entered the market. This "market-based" approach moves far too slowly, and it stops well short of the desired destination.

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[30] 47 USC § 10.

Like the market-based approach proposed in the Notice, the U S WEST proposal would deregulate access services on a phased basis. As a local market opens to competition, the ILEC receives greater regulatory freedom. We part company from the market-based approach of the Notice in two significant respects: the criteria used to measure a market's readiness for competition and the end result.

We believe the ability of competition to constrain the ILEC in a market is not dependent on a particular competitive result: it turns, rather, on the conditions in the market. That is, if conditions are right for competitive entry, that fact alone will constrain the activities of the ILEC, even if no competitor has actually entered the market. If a competitor has entered the market, its presence will further constrain the ILEC, even if it has only a very small market share. Hence the milestones in the U S WEST proposal focus on the accomplishments of the ILEC in opening the local market, rather than on the actions of competitors in availing themselves of the opportunity to enter.

U S WEST believes the Commission should go much further in deregulating the ILECs than what it has proposed in the market-based approach of the Notice. When an ILEC's local exchanges are open to competition -- when it has one or more interconnection agreements in place -- the ILEC should have the freedom to price to the market. When competition is present, the ILEC should receive the relaxed regulatory treatment the Commission has afforded non-dominant carriers. Indeed, at that point, we believe an ILEC will have met the statutory test for regulatory forbearance.

At bottom, the issue in this proceeding is the ILECs' market power -- the ability to control output and price -- over interstate services. Given regulation, the ILECs today have no market power: they cannot control price. Even when access becomes deregulated, the existence of unbundled network elements priced at economic costs -- and subject to ongoing regulation -- will preclude the ILECs from controlling the price of access. The customers of the predominant interstate services -- the IXCs -- are knowledgeable and sophisticated; some are larger than the biggest ILEC. When competitive sources are available to them, they will seize those opportunities -- or create them on their own by entering the local market.[31] With network interconnection, unbundled network elements and resale of local exchange service freely available -- and with regulatory commissions ready to field complaints of unfair treatment -- no one can credibly argue that an ILEC will have the ability to restrain the supply of exchange access, once interconnection agreements are in place. And, absent that ability, the ILECs will be powerless to dictate price.

Finally, the Commission must resist the temptation to micro-manage the transition from regulation to competition. Competition is messy and imperfect, and the transition to competition will be messy and imperfect as well. But if the Commission attempts to ensure that all providers and all consumers of telecommunications services are never adversely impacted, true competition will never become a reality. Given the industry's experience with the emergence of long-

[31] See Exhibit 1 at 7-16

distance competition, and considering the experience in other industries, such as the airline industry, we can safely predict that the benefits of competition will flow unevenly to consumers and some may suffer inconvenience. The Commission can surely enact rules to prevent the worst sort of abuses. But if it attempts to "protect" all consumers from all possible ill effects of competition, the industry will never have effective competition or anything resembling true deregulation.

B. A MARKET-BASED APPROACH TO ACCESS REFORM MUST PROVIDE GREATER DEREGULATION FASTER (¶¶161-217)

The Notice proposes, as one alternative to access reform, a "market-based" approach, in which ILECs would receive regulatory freedom in two phases as their local markets open to competition. Though the market-based approach is certainly preferable to the "prescriptive" approach, U S WEST believes it may fairly be characterized as "too little, too late." That is, the market-based approach will provide the ILECs too little flexibility and, given the proposed criteria for each of the two phases, it will deliver that flexibility far too late. Indeed, the market-based approach stops far short of the ultimate goal intended by the Congress: full deregulation.

These shortcomings are exacerbated by the Commission's Interconnection Order, which has created huge dislocations in the ILECs' pricing and revenue streams, and will continue to do so until the Commissions and the state commissions have implemented rate re-balancing and other necessary reforms.

Below, we will discuss the changes necessary to the market-based approach to ensure that it enables the ILECs to meet their competitors in the marketplace thus ensuring that all consumers receive the benefits of competition.

U S WEST supports the proposal for a phased approach tying the deregulation of access services to the ILECs' accomplishments in opening their markets to competition for local exchange service. The question, though, is how much regulatory freedom how fast. We will show below that the Commission should allow the ILECs considerably more regulatory freedom, and it should do so much more quickly than the Notice proposes.

1. Phase 1: Regulatory Flexibility To Meet Competition

a. Phase 1 Conditions (¶¶169-179)

The market-based approach proposed in the Notice would provide the ILECs four categories of regulatory freedom once they have established the existence of the conditions for Phase 1, "potential competition." The proposed conditions are:

- the availability of unbundled network elements at geographically-deaveraged, TELRIC-based rates;[32]
- the availability of transport and termination (i.e., reciprocal compensation) at cost-based rates;
- the availability of the ILEC's retail services to resellers at a wholesale price;
- the availability to competitors of dialing parity and number portability;

[32] Any condition based on the required pricing of network elements must necessarily reflect the outcome of the pending appeals of the Commission's Interconnection Order. U S WEST incorporates herein the arguments it has made to the Court of Appeals regarding the defects in the Commission's TELRIC pricing methodology.

- the availability to competitors of access to the ILEC's rights-of-way;
- the ability of competitors to order and receive network elements and services "in a commercially reasonable manner and in necessary quantities;" and
- the existence of open and nondiscriminatory network standards.

Most of these conditions will be met when the ILEC has in place one or more interconnection agreements. Others -- particularly the last two listed above -- are relatively subjective. When an ILEC applies for Phase 1 status, we can confidently expect a flood of allegations of non-compliance from those who stand to benefit by continued regulatory shackles on the ILECs.[33] The procedure proposed in the Notice -- a 90-day review cycle -- virtually guarantees endless litigation. And such a procedure is necessary only because the proposed criteria include subjective factors.

The better course is simply to trigger Phase 1 in a state when an ILEC has in place a signed interconnection for that state. These agreements have been intensively negotiated -- and typically arbitrated by the state commissions -- and are subject to state-commission approval and ultimate appeal to the courts. Once in place, an interconnection agreement reflects considered judgments regarding what is required to open the ILEC's network to local competition.

The Commission should not overlay this process with yet another procedure to assess the quality of the interconnection agreements. Yet, that is essentially what the Notice would do.

[33] See Exhibit 1 at 29-41.

Phase 1 status does not empower the ILECs to raise rates (other than increases associated with deaveraging), thus protecting the consumers of the ILEC services. In any event, in Phase 1, an ILEC's local markets will be open to competitive entry; given the size and sophistication of exchange access "consumers," that threat alone will constrain the ILEC's prices.

Given all this, Phase 1 should have a single, objective trigger: the execution of an interconnection agreement. With that single criterion, process becomes a simple matter. The ILEC would submit the executed agreement to the Commission; absent a contrary Commission determination within a short period of time (30 days or less), the ILEC would enter Phase 1.

b. Phase 1 Reforms (¶¶180-200)

Under the market-based approach proposed in the Notice, ILECs who meet the Phase 1 conditions would be given additional pricing flexibility in four respects. U S WEST believes all four of the proposed freedoms are appropriate in Phase 1.

Geographic Deaveraging. In the Notice, the Commission proposes to allow Phase 1 ILECs to deaverage rates geographically for all access charge elements, except the SLC. An ILEC should have this flexibility in Phase 1, particularly if it has been required to (or has chosen to) deaverage its rates for network elements. In that circumstance, without corresponding access-charge deaveraging, competitive entrants would have a built-in advantage in low-cost areas: they could purchase unbundled network elements at cost and provide access in competition with the ILEC, whose prices would be tied to a higher (averaged) cost, thereby providing a

protective price umbrella to the new entrants. This sort of economic inefficiency would deprive the residents of low-cost areas of the full benefits of competition.

If the ILECs deaverage their rates for access services, they should, at a minimum, be allowed to follow the geographic areas used to deaverage unbundled network elements. The better approach, though, would allow the ILECs to deaverage along any geographic lines they wish. That will give them the freedom to meet competition most effectively and bring the benefits of competition to all their access charge customers most quickly. Of course, it does nothing to solve the greater problem of deaveraging the ILECs' local exchange rates, without which they will have little ability to compete with CLECs providing local service by means of deaveraged unbundled network elements.

Volume and Term Discounts. The existing Part 69 rules permit ILECs to offer volume and term discounts for their special access services. The Notice proposes extending that flexibility to switched access services offered by the Phase 1 ILECs. The ILECs' ability to offer volume and term discounts will be essential to their ability to compete: the CLECs will surely offer such discounts, and without comparable flexibility, the ILECs will be unable to compete effectively.

The Notice asks whether the Commission should require cost justification for these discounts. U S WEST believes that is unnecessary in a competitive environment in which competitors can enter a market with relative ease by purchasing unbundled network elements from the ILEC. The logic behind below-cost (predatory) pricing is that a dominant firm can "buy" market share by selling at a loss. It then recoups its losses, either by charging supra-competitive rates once its

rivals have been forced out of the market, or by charging supra-competitive rates on other services. But in a world of unbundled network elements, the ILEC can never recover its losses. Entering the market is too easy to permit the ILEC to charge supra-competitive prices for a long enough period to make the scheme profitable.

Predatory pricing thus becomes an irrational strategy,[34] and the Commission need not enact protections against it.

Contract Tariffs and Individual RFP Responses. The Commission proposes to permit ILECs to offer contract tariffs after they have met the Phase 1 criteria. The ILECs would be required to make each contract publicly available, by means of a tariff filing, and they would have to provide the services on the same terms to similarly situated customers. The Commission also proposes to permit ILECs to offer competitive-response tariffs, but only when they are in response to a competitor's offer to an end user.

U S WEST supports this proposal (Section I.B., supra). The Commission recognized the benefits contract tariffs and RFP responses provide customers when it allowed AT&T to file contract-specific pricing in its Tariff 12. It permitted AT&T to file contract prices with minimal cost support and allowed the contract prices to become effective, so long as AT&T was willing to make the terms and prices available to similarly-situated customers. AT&T was given this pricing flexibility before the Commission determined AT&T to be a "non-dominant" carrier.

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[34] Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574 (1986); A.A Poultry Farms, Inc. v. Rose Acre Farms, Inc., 881 F.2d 1396 (7th Cir. 1989), cert. denied, 494 U.S. 1019 (1990).

Allowing the ILECs to file contract tariffs will spread these competitive benefits to additional segments of the market and more customers. The Phase 1 conditions and the emergence of a competitive marketplace will ensure that the price disciplines necessary to control the ILECs' prices are in place.

Deregulation of New Services. In this portion of the Notice, the Commission considers deregulation of the ILECs' new access services after they meet the Phase 1 criteria. Thus the ILECs would be relieved of the burden of seeking a waiver prior to offering new access services. New services -- including some recently-introduced services whose introduction required a waiver -- would also be removed from the offering ILEC's price-cap structure.

U S WEST supports this proposal. Developing innovative new services is an essential attribute of competition, and the Commission should take all reasonable steps to encourage all competitors in this direction. Given the existence of competition and the ability of competitors to obtain the network capabilities involved in a new service by purchasing network elements, any new service offered by an ILEC will quickly become competitive. Moreover, the availability of existing services will adequately protect consumers against any potential abuse.

c. Elimination of Rate Structure Rules

U S WEST believes the Part 69 rate structure rules should cease to apply to an ILEC once it has met the Phase 1 conditions. Because they codify a particular rate structure, the Commission's Part 69 rules prevent ILECs from responding to competitive market conditions. The rules force the ILECs to develop rates that are

uneconomical and not based on the costs incurred to provide the service. The resulting prices deprive customers of a competitive benefit.

2. Phase 2: Actual Competition

As described in the Notice, Phase 2 presents a cautious extension of the freedoms granted the ILECs in Phase 1. U S WEST believes the Commission's Phase 2 proposal is overly restrictive, in that it would wait too long to grant additional regulatory flexibility and it grants insufficient freedom. When an ILEC faces actual competition -- the premise of Phase 2 -- it should be subjected to only the minimum regulation necessary to protect against abuses that can realistically be expected to occur without it. The antitrust laws and residual Commission authority will adequately protect against anticompetitive behavior by the ILECs.

We believe the Commission's proposal comes up short, in that it would require the ILECs to demonstrate much more than the presence of actual competition and it would leave them too strictly regulated. We explain below that, once an ILEC faces actual competition anywhere within a state, the Commission should regulate the ILEC essentially as it regulates non-dominant carriers.

a. The Phase 2 Conditions (¶¶202-210)

The Notice poses three possible conditions for Phase 2 relief:

- demonstrated presence of competition;
- full implementation of competitively-neutral universal-service support mechanisms; and
- credible and timely enforcement of pro-competitive rules.

Only the first of these is an appropriate condition for Phase 2 relief, and we believe it can and should be implemented much more simply than the Notice proposes.

Demonstrated Presence of Competition. U S WEST agrees that entry into Phase 2 should turn on the presence of actual competition. The Notice goes off the tracks, however, in seeking means by which to quantify the amount of competition that might be "enough" to justify additional regulatory freedom. Any consideration of market share, or any other measure of the success of the new competitive entrants in penetrating the market, will inevitably lead to contentious regulatory proceedings as the ILECs and their competitors debate the evidence of their relative success in the market. The predictable result will be to delay the Phase 2 freedoms for the ILECs, which will also delay the receipt by consumers of the full benefits of competition.

Such a delay might be justified if market share were an apt measure of the restraint imposed on the ILECs by competition. But it is not. If a competitor is actually in the market serving any customers, and if it has the ability readily to serve others, whether by means of its own facilities or through the use of network elements, its presence will restrain the practices of the ILEC, regardless of the competitor's actual market penetration. This is so because it is the threat of losing customers that restrains a participant in a competitive market. Market share demonstrates only the relative ability of the participants to respond to each other's competitive thrusts; it says nothing about the competitive state of the market. Indeed, market share may say very little or nothing about the success (profitability) of the competitors.

U S WEST thus believes that relying on market share -- or any other measure of the new entrants' success in obtaining customers -- to determine an ILEC's eligibility for Phase 2 relief would be a grave error. When a single competitor has in place an operational interconnection agreement and is providing local exchange service and access service to a single customer, either by means of its own facilities or through the use of unbundled network elements, the ILEC should be immediately eligible for Phase 2 treatment. At that point, actual competition exists in the marketplace, and the competitor has the wherewithal to serve the entire market.

The Commission is correct in its belief that actual competition will emerge at different times in different locations and perhaps for different services as well. We can confidently predict that competitors will initially target the larger cities served by an ILEC because they provide a larger concentration of potential customers and probably the more lucrative customers.[35]

Nonetheless, the fact remains that a new entrant with an operational local interconnection agreement has the authority to provide service in the entire state and the wherewithal to do so wherever the ILEC operates. And once it is providing service anywhere in the state, the competitor will have in place the basic infrastructure that it must provide or obtain (customer-service functions, billing capability, and the like), leaving it free to move into all areas of the state very quickly.

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[35] See Exhibit 1 at 16-29.

Thus when the ILEC faces actual competition -- when a single competitor begins to serve a single customer -- it should move to Phase 2.

Implementation of Competitively-Neutral Universal Service Support Mechanisms/ Enforcement of Pro-Competitive Rules. The Notice proposes two additional conditions for entry into Phase 2. Unlike an actual competitive presence, however, the fulfillment of these conditions depends heavily on the actions of entities other than those who will be competing. When universal service support mechanisms will get implemented and the nature of those mechanisms is a matter to be determined by the Federal-state joint board, the Commission and the state commissions.[36] Though industry participants obviously will have input into those determinations, they cannot control them. The same is true of pro-competitive rules the Commission and state commissions might adopt.

If the Commission were to use either of these as conditions for Phase 2, an ILEC could easily find itself facing substantial competition, but unable to launch a meaningful response because the parties are before the Commission arguing whether the state commission has acted "vigorously and swiftly" to enforce pro-competitive rules. U S WEST believes the Commission should encourage the ILECs and their competitors to do battle in the marketplace, not in regulatory proceedings.

b. The Phase 2 Reforms (¶¶211-217)

[36] Though implementation of universal service support mechanisms should not be a criterion for entry into Phase 2, the universal service proceeding is inextricably linked to this proceeding. To the extent that universal service funds do not fully compensate the ILECs for their transition costs, the Commission must address that shortfall in this docket. (See, section V, infra)

As described in the Notice, Phase 2 would provide the following additional regulatory flexibility to the ILECs:

- the ability to differentiate access prices by class of customer;
- elimination of the rate-structure rules for the transport and local-switching rate elements;
- elimination of the service categories in the trunking and traffic-sensitive baskets; and
- consolidation of the traffic-sensitive and trunking baskets.

U S WEST believes the Commission should implement the last two of these reforms immediately (see, section I.B., supra.), and certainly no later than Phase 1. These rules violate the fundamental premise of price caps and interfere with the economic forces of competition. Their elimination is long overdue. Thus, while U S WEST agrees with the proposal to eliminate these rules, we believe it should take place long before Phase 2.

As previously indicated (see, section II.B.1.b., supra), U S WEST believes the Commission should allow ILECs to differentiate access prices by class of customer and eliminate the rate-structure rules for the transport and local-switching rate elements in Phase 1. The Commission's proposal thus gives the ILECs nothing more than what they should already have before they meet the Phase 2 conditions. U S WEST believes the Commission can and should go much further in Phase 2.

The Commission's proposal assumes that the market will not govern the ILECs' provision of access, even though they face actual competition. In this, the Commission gives competitive markets too little credit. Once they face actual competition, the ILECs will have no market power. Again, the "consumers" in this

market are large, sophisticated, vocal companies. If a competitor is available to offer them a better deal, they will take advantage of it. And if the existing competitors are unable to do that, the IXCs are fully capable of going into the local business themselves, as a number of them plan to do in any event.

U S WEST believes the Commission can safely go further in Phase 2, and that it should do so. The Commission's rules prescribe that carriers should be regulated as non-dominant when they lack market power, the ability to control price.[37] When an ILEC qualifies for Phase 2 -- when it faces actual competition -- it will have no ability to control the price of access. Thus, when an ILEC qualifies for Phase 2 treatment, the Commission should essentially regulate it as a non-dominant carrier. That is, in Phase 2, an ILEC should no longer be subject to price caps, or to the rules prescribing access charges, and its tariff filings should take effect on one-day's notice and with a presumption of lawfulness.

3. Forbearance (¶¶152-55)

The Notice stops at Phase 2, thereby implying that the freedoms granted at that stage are sufficient, regardless of the state of local competition in the future. That, we believe, is a serious shortcoming of the Notice.

We noted above that the 1996 Act requires the Commission to forbear regulation when regulation is no longer necessary because competition provides sufficient constraint on the ILEC's activities to protect consumers and to preclude competitive abuses.

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[37] 47 CFR § 61.3(o), (u).

The conditions necessary for forbearance from all regulation are established in Section 10. Thus the Commission must forbear the enforcement of a regulation or a provision of the Communications Act when:

- its enforcement is unnecessary to ensure just, reasonable and nondiscriminatory charges, practices and classifications in connection with telecommunications carriers and services;
- its enforcement is unnecessary to protect consumers; and
- forbearance is consistent with the public interest, which may be equated with the promotion of competition.

Section 10(c) authorizes a carrier to petition for forbearance at any time. The Commission then has one year (which it may extend by 90 days) to issue a determination.

U S WEST believes the existence of actual competition will effectively satisfy these conditions: when an ILEC qualifies for Phase 2, it also qualifies for forbearance. The Commission can thus expect to begin seeing forbearance petitions once the ILECs have met the Phase 2 conditions, if not sooner. The Commission should initiate a proceeding to prescribe streamlined proceedings to resolve forbearance petitions. To require an ILEC to endure a proceeding lasting up to a year (and potentially longer) after it has qualified for forbearance would simply hinder the ILEC in the marketplace to no useful purpose. If, as we suspect, the Commission can devise procedures to accelerate the review process, it will thereby advance the cause of competition.

The Notice asks whether high-capacity special access services should be removed from price-cap regulation; it further invites parties to suggest other ILEC

services they believe are subject to substantial competition. U S WEST believes special access (as well as direct trunked transport in collocated offices) is now subject to substantial competition. We also believe directory assistance and the ILECs' interexchange services are also subject to substantial competition.

These services are certainly eligible for non-dominant regulation, and the Commission should grant them that status. We further believe, however, that these services meet the statutory criteria for forbearance, and we anticipate filing a Section 10(c) petition in the near future.

C. The Commission Must Continue The Requirement That IXCs May Use Unbundled Network Elements To Provide Exchange Access Only If They Have A Relationship With The End User To Provide Local Exchange Service (¶54) .....

In the Interconnection Order[38] the Commission determined that IXCs may use network elements to originate and terminate interexchange calls only if they provide local service to the end user. That is, an IXC may not purchase network elements simply as a means of avoiding the payment of the ILEC's access charges.

The Notice tentatively concludes "that unbundled network elements should be excluded from the Part 69 access charge regime, regardless of whether the carrier that purchases unbundled network elements uses those elements to provide local exchange services or exchange access services."[39] This statement could be read to imply that IXCs may buy network elements in lieu of access charges.

[38] Interconnection Order ¶ 357.

[39] Notice ¶ 54.

If the Commission were to implement such a rule, it would effectively eliminate access charges as a discrete set of services: IXCs would simply purchase network elements, and no additional competition would be added to the local exchange. The effect of this would be only a drastic re-pricing of exchange access. Such a position would be at odds with the Commission's stated objective of promoting local competition: IXCs would get a huge price break on exchange access without having to compete for the local exchange business.

Setting the price of access at the price of its unbundled network elements would be inappropriate. Access is a finished service that requires network integration and operations management to work effectively. Buying access service is not at all the same as buying the unbundled network elements.

For all these reasons, the Commission should reaffirm the conclusion in the Interconnection Order that IXCs may use network elements to originate and terminate interexchange calls only if they have established a relationship with the end user to provide local exchange service.

III. Prescriptive Approach (¶¶ 218-240)

Under the prescriptive approach, the Commission proposes a number of methods which it assumes would quickly drive access rates to cost-based rates. One method would be to simply order access rates that mirror the rates in place for local interconnection. A second method would be to drive rates toward a prescribed rate of return (11.25%). A third method would be to drive rates downward through manipulation of the price cap productivity factor.